

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 SP-02 AID-05 EB-07 NSC-05 CIEP-01

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FRB-03 INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03 LAB-04

SIL-01 L-03 H-02 PA-01 PRS-01 /087 W

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R 271842Z JUN 75

FM AMEMBASSY BONN

TO SECSTATE WASHDC 1081

INFO AMEMBASSY ROME

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DEPARTMENT PASS TREASURY, CEA AND FRB

E.O. 11652, N/A

TAGS: EFIN, GW

SUBJECT: IFO INSTITUTE FORECAST AND CHANCELLOR SCHMIDT'S
COMMENTS ON ECONOMIC POLICY

REF: (A) BONN 10090, (B) BONN 9893, (C) BONN 9264

SUMMARY. THE IFO INSTITUTE IN A PESSIMISTIC REPORT

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FORECASTS A REAL DROP IN GNP OF 2.5 TO 3 PERCENT IN

1975, AND AVERAGE UNEMPLOYMENT OF 5 PERCENT. CHANCELLOR SCHMIDT STATED THAT THE MORE PRONOUNCED DOWNSWING IN THE CURRENT CYCLE COULD LEAD TO AN EQUALLY SHARP UPTURN. AS A RESULT HE CAUTIONED AGAINST EXPANSIONARY EXCESSES THAT COULD REKINDLE INFLATION. HOWEVER, HE PLACED UNEMPLOYMENT AT THE HEAD OF THE PRIORITY LIST. END SUMMARY

1. THE IFO INSTITUTE OF MUNICH ON JUNE 25 RELEASED ITS LATEST FORECAST FOR 1975 ECONOMIC PERFORMANCE IN WHICH IT SEES A DECLINE IN REAL GNP OF 2.5 - 3 PERCENT. WHILE THIS REPRESENTS QUITE A TRIMMING DOWN FROM THE ZERO GROWTH JOINT FORECAST OF THE FIVE MAJOR INSTITUTES MADE TWO MONTHS AGO AND THAT OF THE FRG PUBLISHED IN LATE MAY, IT DOES CONFIRM THE EMBASSY FORECAST MADE JUNE 23 (SEE REFTEL A).

A. FOR THE FIRST HALF OF THIS YEAR, IFO CALCULATES A 4 PERCENT DROP IN GNP FROM THE SAME PERIOD LAST YEAR, AND A 1 PERCENT DESCENT IN THE SECOND HALF. A MAJOR CAUSE FOR NEGATIVE GROWTH IS JUDGED TO BE WEAK FOREIGN DEMAND, WHICH THE INSTITUTE ESTIMATES WILL CAUSE THE FRG'S EXPORTS OF GOODS TO DECLINE IN REAL TERMS BY 7 - 9 PERCENT IN 1975. THE PRESENT RECESSION IS MORE PRONOUNCED THAN THAT OF 1966-67, SAYS THE INSTITUTE.

B. UNEMPLOYMENT, IFO ESTIMATES, WILL AVERAGE 1.1 MILLION, OR 5 PERCENT, FOR THE YEAR 1975. THE JAN.-FEB. 1975 SEASONAL PEAK OF 1.2 MILLION WILL PROBABLY AT LEAST BE REACHED IF NOT EXCEEDED IN 1976, ACCORDING TO THE IFO REPORT. ALSO FOR 1976 AS A WHOLE, PROSPECTS ARE DIM. IT IS ONLY WHEN REAL GNP GROWTH EXCEEDS 5 PERCENT THAT ANY APPRECIABLE IMPROVEMENT ON THE LABOR MARKET CAN BE EXPECTED. THE INSTITUTE'S SURVEY OF BUSINESS HAS CONTINUED TO REFLECT A WORSENING OF EXPECTATIONS IN MAY, SO ANY IMMINENT PICK UP IN INVESTMENT IS NOT FORESEEN, AND FURTHER REDUCTIONS IN THE LABOR FORCE ARE ANTICIPATED FOR THE COMING MONTHS.

C. DESPITE THIS PESSIMISTIC VIEW, THE INSTITUTE OPINES THAT THE BOTTOM OF THE BUSINESS CYCLE HAS BEEN LIMITED OFFICIAL USE

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REACHED. PRIVATE CONSUMPTION POSSIBILITIES AND PROSPECTS FOR REPLENISHMENT OF THE LOW INVENTORY LEVELS ARE THE POTENTIALLY BRIGHT SPOTS THAT GIVE PROMISE OF A BETTER FUTURE. DANGER IS SEEN IN THE APPLICATION OF ANY ADDITIONAL EXPANSIONARY MEASURE AT THIS TIME SINCE THEIR EFFECT COULD COINCIDE WITH THE RECOVERY OF FOREIGN AND DOMESTIC DEMAND WITH THE RESULTANT EXCESS DEMAND LEADING TO UNDESIRABLE INFLATIONARY PRESSURES. CAUTIONED

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INFO AMEMBASSY ROME

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AGAINST, THOUGH, WAS ANY CUTBACK IN PUBLIC SECTOR
EXPENDITURES IN RESPONSE TO DEFICITARY PROBLEMS.

D. FOR THOSE INTERESTED IN THE DETAILS OF THE IFO
FORECAST, THE FOLLOWING TABLES ARE PROVIDED:

TABLE I

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1975 GNP (1962 PRICES)

PERCENT CHANGE OVER PREVIOUS YEAR

LST HALF 2ND HALF FULL YEAR

PRIVATE CONSUMPTION	1.5	2.5	2
PUBLIC CONSUMPTION	2.0	3.5	3
INVESTMENT			
EQUIPMENT	-5.0	-7.0	-6
CONSTRUCTION	-10.0	-4.0	-7
CHANGES IN STOCKS (BIL DM)	3.5	-4.0	-0.5
NET FOREIGN BALANCE (BIL DM)	11.0	8.5	19.0
EXPORTS	-7.0	-4.0	-5.5
IMPORTS	0.5	1.5	1.0
GNP	-4.0	-1	-2.5 TO -3.0

TABLE II

1975 GNP (CURRENT PRICES)

PERCENT CHANGE OVER PREVIOUS YEAR

LST HALF 2ND HALF FULL YEAR

PRIVATE CONSUMPTION	7.5	8.5	8
PUBLIC CONSUMPTION	10.0	10.5	10.5
INVESTMENT			
EQUIPMENT	1.5	-1.5	0
CONSTRUCTION	-7.0	-1.5	-4
CHANGES IN STOCKS (BIL DM)	4.5	-6.5	-2
NET FOREIGN BALANCE (BIL DM)	19.5	17.0	36.5
EXPORTS	2.5	0.5	1.5
IMPORTS	3.5	2.0	2.5
GNP	4.5	6.0	5 TO 5.5

TABLE III

1975 PRICE DEVELOPMENTS

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PERCENT CHANGE OVER PREVIOUS YEAR

LST HALF 2ND HALF FULL YEAR

PRIVATE CONSUMPTION	6	6	6
PUBLIC CONSUMPTION	8	7	7.5
INVESTMENT			
EQUIPMENT	7	6	6.5
CONSTRUCTION	3.5	2.5	3
EXPORTS	10.5	4.5	7.5
IMPORTS	2.5	0.5	1.5
GNP	9.0	7.5	8.5

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2. CHANCELLOR SCHMIDT SPEAKS ON ECONOMIC POLICY.

A. DURING A PRESS CONFERENCE ON JUNE 25, CHANCELLOR SCHMIDT SUGGESTED THAT THE ANTICIPATED UPSWING THIS TIME COULD WELL TURN OUT TO BE MORE PRONOUNCED THAN IN PREVIOUS CYCLES. A SYNCHRONOUS WORLD RECESSION IS APT TO BE FOLLOWED BY A COMPARABLY SYNCHRONOUS AND MUTUALLY LIMITED OFFICIAL USE

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PROPELLANT UPSWING, HE ARGUED, SUGGESTING THAT HE FORSEES THE DANGER OF POSSIBLE EXCESSES. REGARDING THE POSSIBILITY OF ADDITIONAL EXPANSIONARY MEASURES, THE CHANCELLOR ASSERTED THAT THE GOVERNMENT HAS NO INTENTION OF OPENING THE DOORS TO RENEWED INFLATIONARY GROWTH. ON THE OTHER HAND, SCHMIDT ONCE AGAIN REFERRED TO 5 PERCENT UNEMPLOYMENT (THE CURRENT RATE ON A SEASONALLY ADJUSTED BASIS) AS THE POINT AT WHICH MAINTENANCE OF EMPLOYMENT MOVES UP TO THE NUMBER ONE POSITION ON THE PRIORITY LIST. A PRICE INCREASE FACTOR OF 6.1 PERCENT (THE CURRENT RATE OF LIVING COSTS, EVEN OVER A LONGER PERIOD OF TIME, IS MORE TOLERABLE THAN SUSTAINED UNEMPLOYMENT OF 5 PERCENT, HE SAID. IN ANOTHER VAGUE STATEMENT HE SEEMED NOT TO RULE OUT THE POSSIBILITY OF ADDITIONAL STIMULATIVE MEASURES.

B. THE CHANCELLOR ANNOUNCED THAT NEW TAX REVENUE ESTIMATES AND NEW MACRO-ECONOMIC PROJECTIONS WILL BE SUBMITTED TO THE CABINET BY THE END OF AUGUST, I.E., IN TIME FOR THE FORTHCOMING 1976 BUDGET DELIBERATIONS.

C. TURNING TO COORDINATION OF U.S.-GERMAN ECONOMIC POLICIES, SCHMIDT ONCE AGAIN (ALSO SEE REFTEL C) MENTIONED THE RECENT SIMON/BURNS VISIT, IMPLYING THAT THIS VISIT TOOK PLACE UPON HIS SUGGESTION. HE WENT ON TO SAY THAT BOTH THE U.S. AND THE FRG GOVERNMENTS ARE AWARE THAT AN UPTURN OF THE WORLD ECONOMY IS HARDLY CONCEIVABLE WITHOUT REVIVAL IN THE U.S. BOTH REALIZED THAT A PARALLEL DEVELOPMENT OF U.S. AND GERMAN POLICIES IS "URGENTLY DESIRABLE," AND THIS, SCHMIDT SAID, SO FAR WAS AND WILL CONTINUE TO BE ACHIEVED.

3. COMMENT: THE CHANCELLOR'S CAUTIOUS STANCE RE ANY
NEW STIMULATIVE MEASURES, DESPITE THE GROWING UNEMPLOY-
MENT AND THE UNLIKELIHOOD OF IMPROVEMENT IN ELECTION
YEAR 1976, COULD BE A CALCULATED EFFORT TO MODERATE THE
INEVITABLE. PRESSURES ARE SURE TO MOUNT, PARTICULARLY
WITHIN THE SPD, FOR EXPANSIONARY ACTION, AND THE
CHANCELLOR IN ANTICIPATION MAY BE SETTING THE STAGE TO
CURB EXCESSES IN SUCH DEMANDS. COINCIDENTALLY (OR
OTHERWISE), THE IFO POLICY RECOMMENDATION (AS WELL AS
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THAT FROM THE KIEL INSTITUTE REPORTED REFTEL B) NICELY
SUPPORT THIS CONSERVATIVE APPROACH. END COMMENT. HILLENBRAND

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